

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE PROVINCIAL LEGISLATURE
AND COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION
OF NALA LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Nala Local Municipality (NLM) which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1, in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act no.1 of 2007) (DORA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit in accordance with the International Standards on Auditing and General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008. Because of the matters discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. I conducted my audit in accordance with the International Standards on Auditing read with General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by NLM in this respect will be limited to reporting on non-compliance with this disclosure requirement.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for disclaimer of opinion

Comparative balances

8. In my previous audit report dated 4 June 2008 I was unable to express an unqualified audit opinion on the financial statements of the municipality for the year ended 30 June 2007. The qualification matters have not been adequately resolved and my audit report regarding the corresponding figures for the year ended 30 June 2008 is modified accordingly. I was unable to perform alternative audit procedures.

Financial system and accounting framework conversion

9. The municipality converted to a new financial system at the end of the current financial year and at the same time the municipality also converted to a new accounting framework (from IMFO to GAMAP / GRAP).
10. During the conversion process the prior year closing balances were restated to account for the change in accounting policy as well as for prior period errors which were identified. These restatements are disclosed in note 33 to the financial statements. The conversion process was however not attended by the Auditor-General and insufficient supporting documentation was maintained regarding the conversion process to allow for the retrospective audit of the conversion process.
11. During the conversion process the IT consultants had unrestricted access to modify the data inputted into the new system. The IT consultants were also able to post correcting and reallocation journals for which no supporting documentation was maintained and these journals were not formally reviewed and approved by the management of the municipality.
12. I could consequently not obtain adequate audit evidence as to whether the restated opening balances as disclosed in note 33 to the financial statements are accurately and completely reflected in the financial statements and whether the amendments made to the original 2006-07 closing balances were in fact valid, approved and supported by sufficient supporting documentation. I could also not obtain adequate audit evidence as to the completeness, accuracy and occurrence of the underlying financial data for the current financial year. I was unable to perform alternative audit procedures.
13. As disclosed in note 36 to the financial statements, the data conversion from the accounting systems was not completed at year end and the results of the conversion of the remaining modules might have an effect on the financial statements of municipality. As at the date of my report, the municipality had not completed its conversion process. I could consequently not obtain adequate audit assurance as to the completeness, accuracy and validity of the underlying financial data.

Net assets

14. As a result of the audit matters detailed below, I was unable to obtain adequate audit evidence as to the existence, rights and obligations, valuation and completeness of net assets amounting to R1 700 543, disclosed in the statement of change in net assets:

- Differences relating to offsetting of depreciation between the government grant reserve and the accumulated deficit in the statement of changes in net assets amounting to R1 201 878 was identified for which no supporting documentation could be obtained. I was unable to perform alternative audit procedures to obtain adequate audit evidence as to the existence and valuation of these transactions and balances.

- Pre-GAMAP reserves and funds amounting to R20 489 321 were identified in the 2006-07 financial statements as well as in note 33 to the current year financial statements which should have been disclosed on the face of the statement of changes in net assets as opening balances together with their respective reallocation to the accumulated deficit during the conversion to GRAP/GAMAP.
- Sufficient supporting documentation could not be obtained for transactions processed in the government grant reserve and the accumulated deficit amounting to R12 443 048. I was unable to perform alternative audit procedures to obtain adequate audit evidence as to the existence and valuation of these transactions and balances.

Non-current provisions

15. The municipality did not provide for the rehabilitation of landfill sites as required by section 28(1) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) and in accordance with the Standard of Generally Accepted Municipal Accounting Practice, GAMAP 19 *Provisions, contingent liabilities and contingent assets* (GAMAP 19). The municipality's records also did not permit the performance of alternative audit procedures regarding the provision for rehabilitation of these landfill sites.
16. Consequently, I did not obtain sufficient appropriate audit evidence as to the completeness, rights and obligations and valuation of non-current provisions and property, plant and equipment in accordance with paragraph 28(e) of GAMAP 17: Property, plant and equipment (GAMAP 17), which requires the capitalisation of future rehabilitation costs of an asset to the extent that these costs have been provided for in terms of GAMAP 19.

Provisions

17. Accruals for leave and bonuses amounting to R3 221 420 (2007: R2 964 622), as disclosed in note 5 to the financial statements, have been incorrectly accounted for in terms of paragraph 10 of the South African Statement of Generally Accepted Accounting Practice, IAS 19 (AC116): *Employee Benefits*. The accruals have been inaccurately classified as current provisions in note 5 instead of as accruals under creditors in note 4.1 in the financial statements. Consequently creditors are understated and current provisions are overstated with the R3 221 420 (2007: R2 964 622).

Creditors

18. Sufficient supporting documentation could not be obtained for creditors amounting to R10 735 346 which was included in the creditors balance under note 4.1. I was unable to perform alternative audit procedures to obtain adequate audit evidence as to the completeness, valuation and existence of creditors.
19. I was unable to obtain adequate audit evidence as to the completeness and valuation of creditors included in note 4.1 as supporting documentation relating to payments amounting to R6 484 059 made to creditors after year end could not be obtained. Alternative audit procedures could not be performed.
20. Creditors with debit balances amounting to R568 976 have not been reclassified as other debtors in the financial statements. Debtors with credit balances amounting to R293 776 have not been reclassified as creditors in the financial statements. Consequently, creditors and other debtors are both understated with the R862 752.
21. Invoices amounting to R1 070 360 that relate to the current financial year were only processed on the financial accounting system after year-end. Consequently, creditors and expenditure are both understated by R1 070 360.

Property, plant and equipment

22. As a result of the audit matters detailed below, I was unable to obtain sufficient appropriate audit evidence as to the completeness, existence, valuation, presentation and disclosure of and the municipality's rights to property, plant and equipment with a carrying value of R39 819 201 (2007: R32 177 726), as disclosed in note 8 to the financial statements for the current and prior financial year:

- For assets with a carrying value of R30 923 712 the descriptions, serial numbers, location and condition of the items as indicated in the fixed asset register were inadequate for identification purposes. Furthermore, the municipality did not conduct an asset verification or update the fixed asset register during the year. The municipality's records did not permit the performance of alternative audit procedures and I was consequently unable to perform all the procedures I considered necessary to obtain adequate audit evidence as to the existence, valuation, completeness, presentation and disclosure of and the municipality's rights to property, plant and equipment amounting to R30 923 712.
- Insufficient information was included in the municipality's erven listing to enable me to obtain adequate audit evidence as to the municipality's rights with regard to erven to the value of R4 274 009. The municipality's records did not permit the performance of alternative audit procedures regarding its rights to the erven.
- Erven with a value of R1 625 350 which conform to the definition and recognition criteria of Property, plant and equipment as stated in GAMAP 17 and which were identified as municipal property on the valuation roll, were not registered in the name of the municipality for the year ended 30 June 2008. Consequently, property, plant and equipment and the accumulated deficit are overstated by this amount.
- Supporting documentation could not be obtained for fixed asset additions amounting to R7 069 736 for the year. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence, rights to and valuation of these assets.
- The depreciation on property, plant and equipment as disclosed in the statement of financial performance amounts to R1 575 649 (2007: R113 200). However, due to the matters listed in the preceding paragraphs I was unable to confirm the completeness, accuracy and occurrence of the depreciation charge for the year. The municipality's records did not permit the performance of alternative audit procedures regarding the depreciation charge.

Inventories

23. I was not invited to attend the year end inventory count over inventory amounting to R850 617 (2007: R251 576) as disclosed in the financial statements under note 11. There is furthermore no inventory system currently in place and the inventory count documentation compiled by the municipality was destroyed after the inventory count. The municipality's records did not permit the application of alternative audit procedures and I could consequently not obtain adequate audit evidence as to the existence and valuation of this inventory.

Consumer and other debtors

24. Paragraph 58 of the South African Statement on Generally Accepted Accounting Practice, IAS 39: *Financial Instruments: Recognition and Measurement* (IAS 39) requires the municipality to assess at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

25. The municipality however made a general provision for doubtful bad debts for consumer and other debtors amounting to R112 225 886 (2007: R68 092 244) and R50 169 329 (R2007: R52 019 299) respectively, as disclosed in note 12 and 13 to the financial statements, which is not in accordance with the impairment requirements of IAS 39. As the

relevant information was not available I was not able to calculate what the impairment charge against consumer and other debtors and bad debts expense should have been if IAS 39 had been applied correctly.

26. Sufficient supporting documentation could not be obtained for journals processed between the provision for bad debts expense in the statement of financial performance and the provision for bad debts in statement of financial position amounting to R42 595 359. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence and valuation of these journals.
27. Included in gross consumer debtors, as disclosed in note 12 to the financial statements, are consumer debtors with balances amounting to R70 730 362 for which I was unable to obtain adequate audit evidence as to the existence, completeness, rights to and valuation of these consumer debtors due to the fact that no payments were received from these consumer debtors during and after the financial year. The municipality's financial systems did not permit me to perform alternative audit procedures.

Investments

28. The municipality has not correctly classify an investment amounting to R1 207 110, as disclosed in note 9 to the financial statements, in accordance with paragraph 67 of the Standard of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* (GRAP 1). This investment matured within 30 days after year end and should have been classified as cash and cash equivalents. Consequently cash and cash equivalents is understated and investments are overstated by R1 207 110.
29. The municipality did not classify the short term call investments amounting to R4 519 739, as disclosed in note 14 to the financial statements, in accordance with paragraph 67 of GRAP 1. These call investments mature within 90 days and should have been classified as cash and cash equivalents. Consequently cash and cash equivalents is understated and investments (short-term) are overstated by R4 519 739.

Cash and cash equivalents

30. Sufficient supporting documentation could not be obtained for journals amounting to R187 121 613 which were posted to the cash general ledger during the financial system conversion process. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the existence, classification and valuation of these journals.
31. Outstanding cheques amounting to R5 078 752 were identified as reconciling items on the bank reconciliation. These cheques were outstanding for more than 6 months at year end and have not been cancelled. These cheques were however included in the amount of outstanding cheques which were added back to cash and cash equivalents and creditors at year end. I could not obtain adequate audit evidence as to whether replacement cheques had been issued for these stale cheques during the year under review. The municipality's financial systems did not permit the performance of alternative audit procedures. I could consequently not obtain adequate audit evidence as to the completeness, valuation and existence of cash and cash equivalents and creditors.
32. Sufficient supporting documentation could not be obtained for reconciling items amounting to R9 907 269 which were included on the year end bank reconciliation. Consequently I could not obtain adequate audit evidence as to the completeness, valuation and existence of the cash and cash equivalents balance disclosed in the financial statements.
33. An unreconciled difference of R4 369 571 was identified between the cash book balance disclosed in the bank reconciliation, R5 085 181, and the amount as per note 14 of the financial statements, R9 454 752. I could not be provided with sufficient supporting documentation relating to the existence and valuation of this difference. The municipality's financial systems did not permit the performance of alternative audit procedures. Consequently, cash and cash equivalents and expenditure are misstated by R4 369 571.

Revenue

34. An unreconciled difference of R12 121 115 was identified between the municipality's valuation roll and the total property valuation as disclosed in note 15 to the financial statements. I could not be provided with sufficient supporting documentation for this difference. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the valuation of property on which assessment rates amounting to R10 028 757 was levied. Consequently I could not obtain adequate audit evidence as to the accuracy, classification, occurrence and completeness of assessment rates levied amounting to R10 028 757.
35. Sufficient supporting documentation could not be obtained for journals amounting to R83 087 000 that were posted to the revenue general ledger accounts. Alternative audit procedures could not be performed to confirm the occurrence, classification and accuracy of these journals.
36. Sufficient supporting documentation could not be obtained regarding the number of sewerage points and refuse bins allocated to consumer debtors upon which refuse removal and sewerage and sanitation charges are levied. The municipality's system did not allow the performance of alternative audit procedures. I could consequently not obtain adequate audit evidence as to the completeness, accuracy and occurrence of revenue from refuse removal services and sewerage and sanitation services amounting to R16 330 960 and R11 572 939 respectively.
37. Included in other income, as disclosed in note 18 to the financial statements, is an amount of R3 088 672 (2007:R15 161) relating to the sales of erven. Sufficient supporting documentation could not be obtained for the sale of these erven. The municipality's financial systems did not permit me to perform alternative audit procedures. Consequently, I was unable to obtain adequate audit evidence as to the occurrence, completeness and accuracy of erven sold during the current financial year.
38. Differences were identified for meter readings and tariffs used to levy service charges during the year. Based on my calculations service charges and consumer debtors are both understated by R5 959 083.

Expenditure

39. Value added Tax (VAT) amounting to R4 777 390 was claimed on expenditure invoices which did not comply with the requirements of a valid VAT invoice as required by the Value-Added Tax Act, 1991 (Act No. 68 of 1991). Consequently, expenditure and the VAT liability were both understated by R4 777 390.
40. Sufficient supporting documentation could not be obtained for expenditure amounting to R90 084 967 and credit expenditure transactions amounting to R4 042 585. Alternative audit procedures could not be performed to obtain adequate audit evidence as to the occurrence, classification and accuracy of expenditure.
41. Retention monies and sureties are required to be withheld from payments made by the municipality to the respective contractors in accordance with the requirements of bucket eradication programme contracts. Retention monies and sureties to be withheld, were however incorrectly calculated resulting in excess payments of R1 674 430 being made to suppliers before the conditions of the contracts had been complied with. The bucket eradication programme is still ongoing and consequently other debtors were understated and general expenses overstated by R1 674 430.
42. Included in general expenses under note 23 to the financial statements is expenditure relating to departmental usage of water, electricity, refuse and sanitation services amounting to R1 309 696 (2007: R982 338). Revenue has also been recognised amounting to R1 309 696. The departmental revenue and expenditure should however have been offset against each other in the financial statements as required by paragraph 42 of GRAP 1. Revenue and expenses are consequently overstated by R1 309 696 (2007: R982 338).

Employee related cost

43. An allocation error amounting to R805 638 was identified between the employee related costs and the remuneration of councillors. Consequently, employee related costs are understated and remuneration of councillors is overstated by R805 638.
44. Sufficient supporting documentation relating to journals amounting to R1 232 203 could not be obtained. I could not perform alternative audit procedures to obtain adequate audit evidence as to the occurrence, accuracy and classification of these journals.
45. Payments amounting to R10 604 875 made to third parties relating to employee deductions could not be traced to the municipality's bank statements. The client's financial systems did not permit the performance of alternative audit procedures. Consequently, I could not obtain adequate audit evidence as to the completeness, occurrence and accuracy of third party payments made.

Cash flow statement

46. I was unable to obtain adequate audit evidence as to whether the cash flow statement and the related notes for the current and prior financial year are fairly stated due to the material effect of scope limitations and identified misstatements reported in this report.

Contingent liabilities

47. Contingent liabilities amounting to R3 872 005, as per litigation reported in attorney's letters, were not disclosed in note 29 to the financial statements. Contingent liabilities were consequently understated by the above-mentioned amount.

Irregular expenditure

48. In terms of the municipality's Supply Chain Management Policy and section 112(1) of the MFMA, a municipality shall award contracts for goods and services in accordance with a system that is fair, equitable, transparent, competitive and cost-effective. The following irregular expenditure was identified because the above was not complied with. Furthermore, this expenditure was not disclosed in the financial statements as irregular expenditure as required by section 125(2)(d) of the MFMA.

- (a) For payments totalling R518 014, the number of quotations as required by sections 12, 16 and 17 of the municipality's Supply Chain Management Policy was not obtained.
- (b) For payments totalling R7 186 490 no valid tax invoices could be obtained.
- (c) For payments totalling R1 026 698 no tax reference numbers or VAT registration numbers were included on the tender or bid documentation.
- (d) In respect of payments totalling R1 518 048 cheque and payment vouchers were not appropriately authorised.
- (e) Sufficient supporting documentation could not be provided for payments totalling R571 949 that were made to an employee of the municipality. These payments were furthermore made external to the salary system.
- (f) In addition to the above, the municipality's Supply Chain Management policy was not followed for payments totalling R56 441 844 in respect of the following matters regarding tenders:
 - Incomplete tender documentation was provided.
 - Tenders awarded could not be obtained.
 - Tenders did not comply with the conditions and requirements of the bid document or contract.
 - No approval could be obtained for additional capital expenditure incurred relating to tenders.
 - Tenders scoring did not comply with the municipality's point scoring system.
 - No contract register is maintained for contractors who have been awarded tenders.

Unauthorised expenditure

49. The municipality overspent its adjustment budget for the current year by R94 633 072. This expenditure is regarded as unauthorised expenditure in terms of section 1 of the MFMA. The disclosure requirements of section 125(2)(d) of the MFMA relating to unauthorised expenditure have not been complied with.

Incomplete disclosures in the financial statements

50. In terms of paragraphs 31 and 35 of the South African Statement of Generally Accepted Accounting Practice, IAS 17 (AC105): *Leases*, the municipality is required to disclose the minimum lease payments payable over the remainder of the lease period. Lease payments amounting to R3 174 399 were identified in the general ledger during the current financial year. The future operating and finance lease expenditure payable was however not disclosed in the financial statements. I could not obtain adequate audit evidence as to the classification of the above lease payments. Alternative audit procedures could not be performed.

Going concern

51. The municipality incurred a net loss of R24 473 930 for the year ended 30 June 2008 and as of that date the municipality's current liabilities exceeded its total assets by R26 431 607 (2007: R1 813 139). The municipality has not obtained financing to address this matter. This situation indicates the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern. The entity may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements do not disclose this fact.

Disclaimer of opinion

52. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Nala Local Municipality. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matters

I draw attention to the following matters:

✓ ✓ ✓

Basis of accounting and amendments to the applicable basis of accounting

53. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.
54. As set out in accounting policy note 1, the National Treasury approved a deviation from the basis of accounting applicable to the municipality in terms of *General Notice 522 of 2007*, issued in *Government Gazette No. 30013 of 29 June 2007*.

Fruitless expenditure

55. As disclosed in note 35 to the financial statements, fruitless expenditure to the amount of R3 091 520 was incurred during the current financial year due to interest incurred on external loans due to the non-payment of loan premiums.

Restatement of corresponding figures

56. As disclosed in note 32 and 33 to the financial statements, the corresponding figures for the financial year ended 30 June 2007 have been restated as the municipality has implemented the Standards of Generally Accepted Municipal Accounting Practice and Generally Recognised Accounting Practice.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Material inconsistencies in information included in the annual report/other information

57. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

Unaudited supplementary schedules

58. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1. The supplementary budget information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. Accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

Local Government: Municipal Finance Management Act, 2003 (MFMA)

59. Payments to suppliers totalling R3 902 433 were not made within 30 days of date of receipt of the relevant invoice or statement, as prescribed by section 65(2)(e) of the MFMA.
60. Included in gross consumer receivables was an amount of R505 146 (2007: R100 009) that was due to NLM by government institutions, and R313 159 of this balance had been outstanding for longer than 30 days as at 30 June 2008. I could not be provided with adequate audit evidence that the municipality had complied with section 64(3) of the MFMA which requires the accounting officer of the municipality to inform National Treasury in writing of any payments from an organ of state in respect of municipal taxes or services which had been outstanding for longer than 30 days.
61. Particulars of non-compliance with the MFMA were not disclosed in the notes to the financial statements as required by section 125(2)(e) of the act.
62. Section 127(2) of the MFMA states that the mayor of a municipality must, within seven months after the end of a financial year, table in the municipal council the annual report of the municipality. The annual report of municipality for 2006/07 was tabled late to council on 21 February 2008.
63. Section 11(4) of the MFMA states that the accounting officer must within 30 days after the end of each quarter table in the municipal council a consolidated report of all withdrawals made in terms of subsection (1) (b) and submit a copy of the report to the relevant provincial treasury and the Auditor-General. Evidence that the report had been submitted to the relevant treasury and the Auditor-General could not be submitted for audit purposes.
64. In terms of section 53(1)(c)(ii) and 53(3)(b) of MFMA states that the mayor of a municipality must take all reasonable steps to ensure that the municipality's service delivery and budget implementation plan is approved by the mayor within 28 days after the approval of the budget; and that the annual performance agreements as required in terms of section 57(1)(b) of the Municipal Systems Act for the municipal manager and all senior managers — that the performance agreements of the municipal manager, senior managers and any other categories of officials as may be prescribed, are made public no later than 14 days after the approval of the municipality's service delivery and budget implementation plan. Contrary to the above it was noted that the service delivery and budget implementation plan (SDBIP) was approved 44 days after the approval of the budget and adequate audit evidence could not be provided as to whether the approved municipal manager's and senior managers' performance agreements were made public within 14 days after approval of the SDBIP.

65. The municipality has not yet compiled its annual report for the year ended 30 June 2008 and therefore I was unable to confirm whether the accounting officer had complied with the statutory disclosure requirements in section 121(3)(e) to (k) of the MFMA.
66. Contrary to section 65 and 112 of the MFMA and Regulation 46 (1) and 46 (2) of the Municipal Supply Chain Management Regulations, the municipality has not compiled a register for declaration of interests and individual declarations of interest completed by councillors and management are not updated on an annual basis.
67. Contrary to section 98 of MFMA, the municipality did not compile bank reconciliations and creditor reconciliations on a monthly basis during the financial year under review.
68. Contrary to section 71(1) of the MFMA, the municipality did not submit its financial reports to Provincial Treasury within 10 working days after each month end.
69. Contrary to section 111 of the MFMA and Regulation 7(1) of the Municipal Supply Chain Management Regulations, the municipality has not established a Supply Chain Management Unit.
70. Contrary to section 129 of the MFMA, no oversight report was compiled and adopted by Council pertaining to the prior year's annual report.
71. I could not be provided with adequate audit evidence regarding the municipality's compliance with section 54 of the MFMA, regarding budgetary control and early identification of financial problems.

Local Government: Municipal Systems Act, Act No. 32 of 2000 (MSA)

72. Contrary to section 12A of schedule 1 to the MSA, it was noted that accounts in respect of rates and service charges of 14 (2007: 6) councillors, totalling R93 280 (2007: R83 644) had been outstanding for a period of more than three months at year-end.

Governance framework

73. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

74. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
8	Opening Balances	6,7			1	1
9 – 13	Financial system conversion	7,5	6		1	1
14	Funds and Reserves	7,5	6			1
15	Non-current provisions	7,5	6			1
17	Provisions	7,5	6			1
18 -21	Creditors	7,5	6			1
22	Property, plant and equipment	7,5	3,6		1	1
23	Inventory	7,5	3			1
24 – 27	Consumer and other debtors	7,5	6		1	1
28 – 29	Investments	7,5	2			1
30 – 33	Cash and cash equivalents	7,5	6			1
34 – 39	Revenue	7,5	6			1
40 – 43	Expenditure	7,5	6			1
44 – 46	Employee cost	7,5	3,6			1
47	Cash flow statement	7,5	6			1
48	Contingent liabilities	7,5	6			1
49	Irregular Expenditure	4,5	5	1,2,3,5,6		1
50	Unauthorised Expenditure	5	1,6			1
51	Incomplete disclosures in the financial statements	5	6			1
52	Going Concern	5	6			1

Overall reflections on the governance framework based on internal control deficiencies

- 75. The entity does not have individuals competent in financial reporting and related matters.
- 76. The accounting officer did not exercise oversight responsibility over financials reporting and internal control.
- 77. Management has not implemented financial policies and procedures to address all transactions processed.
- 78. Monitoring by senior management did not take place regularly or timeously to prevent and detect errors and non-compliance with internal policies and procedures.
- 79. Monitoring by senior management did not take place regularly and timeously during the financial system conversion which also included the conversion to GAMAP/GRAP.
- 80. Inadequate filing procedures have resulted in significant limitations of scope during the current financial year's audit.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
IC = Information and communication	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
M = Monitoring	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

Key governance responsibilities

81. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
Clear trail of supporting documentation that is easily available and provided in a timely manner			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		X
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		X
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.		X
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.		X
Development and compliance with risk management, effective internal control and governance practices			
6.	Audit committee		
	<ul style="list-style-type: none"> • The municipality had an audit committee in operation throughout the financial year. • The audit committee operates in accordance with approved, written terms of reference. • The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 	X	
7.	Internal audit		
	<ul style="list-style-type: none"> • The municipality had an internal audit function in operation throughout the financial year. • The internal audit function operates in terms of an approved internal audit plan. • The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 	X	
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		X
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(c)(i) of the MFMA.		X
12.	Powers and duties have been assigned, as set out in section 79 of the MFMA.	X	

Follow-up of audit findings		
13.	The prior year audit findings have been substantially addressed	X
14.	Oversight resolutions have been substantially implemented.	X
Issues relating to the reporting of performance information		
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.	X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.	X
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by NLM against its mandate, predetermined objectives, outputs, indicators and targets as per section 68 of the MFMA.	X
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	X

Overall reflections on the governance framework based on other key governance requirements

- 82. Significant difficulties were experienced due to unavailability of requested supporting documentation and the lack of availability of key officials during the audit. The late responses from management on communications of audit findings issued during the audit further complicated the audit.
- 83. The financial statements were subject to material corrections resulting from the audit process which are attributable to the weaknesses in the design and implementation of internal control in respect of financial management, response to identified risks and weaknesses in information systems.
- 84. The final draft of the annual report was not finalised and submitted to my office during the time of my audit.
- 85. The financial statements were only submitted for audit purposes on 28 November 2008 due to the municipality's late decision to convert to a new financial system and to implement the GAMAP/GRAP basis of accounting.
- 86. The municipality did not have a functioning audit committee and internal audit department during the current and prior financial year.
- 87. Policies and procedures related to financial reporting, risk management and compliance with laws and regulations were not established and communicated within the municipality.
- 88. Inadequate senior management monitoring during the financial system conversion process resulted in the financial systems and underlying financial data not being appropriate for the preparation of the financial statements.
- 89. A formal risk assessment has not been conducted during the current and prior financial year and no risk strategies, including a fraud prevention plan, are in place to address the financial and operational risks faced by the municipality.
- 90. The municipality has not substantially addressed all prior year audit findings resulting in a recurrence of audit report qualifications and management report findings.
- 91. According to the responses received in respect of the SCOPA resolutions most resolutions are still in the process of being implemented.

92. The internal controls regarding performance management are not effective, efficient and transparent to ensure that strategic objectives and targets are aligned to the priorities and that actual performance is accurately measured and reported on. Policies and procedures with regards to reporting performance against pre-determined objectives have not been established.
93. The integrated development plan was only approved and implemented at the end of the current financial year. No performance management system was implemented during the current financial year.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

94. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

95. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

96. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

97. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

98. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

No reporting of performance information

99. The annual report of the municipality did not include the annual performance report of the municipality, which is required to be prepared in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.

Content of integrated development plan

100. The integrated development plan of the municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

Existence and functioning of a performance audit committee

101. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

102. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45 of the MSA.

Lack of adoption or implementation of a performance management system

103. The municipality did not adopt a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

No mid-year budget and performance assessments

104. The accounting officer of the municipality did not (by 25 January of each year) assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

APPRECIATION

105. The assistance rendered by the staff of the Nala Local Municipality during the audit is sincerely appreciated.

Auditor-General
Bloemfontein

20 November 2009



Auditing to build public confidence